No. 84-646

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

PEAT, MARWICK, MITCHELL & CO.,

Petitioner,

—against—

DAVID A. and SYLVIA S. LIPTON,

Respondents.

REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

VICTOR M. EARLE, III
Counsel of Record
ANTHONY J. COSTANTINI
Peat, Marwick, Mitchell & Co.
345 Park Avenue
New York, New York 10154
(212) 758-9700

Of Counsel:

WILLIAM E. HEGARTY
CHARLES A. GILMAN
CAHILL GORDON & REINDEL
(a partnership including
professional corporations)
New York, New York

CHARLES P. PILLANS
BEDELL, DITMAR, DEVAULT, PILLANS & GENTRY
Professional Association
Jacksonville, Florida

December 11, 1984

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Because of the procedural posture of this action, the allegations of the amended complaint are taken as true, and thus there are no issues of fact. Petitioner contends that as a matter of law the amended complaint fails to state a claim under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982).

The Eleventh Circuit noted that respondents:

> —"*did not rely* directly on [the allegedly] misleading documents"

(734 F.2d at 741 reproduced in Petitioner's Appendix at 2a, emphasis added). The district court similarly acknowledged:

—"There is *no allegation* that either plaintiff actually relied upon any supposed misrepresentations made by any defendant" (Appendix at 25a, emphasis added)

—"*plaintiffs concede* that their federal securities law claim is based on what has become known as the 'fraud on the market' theory." (Appendix at 24a, emphasis added).

Thus, respondents' pleading constitutes judicial admissions binding upon them. *See* 9 J. Wigmore, *Wigmore on Evidence* § 2588 *et seq.* (Chadbourn rev. 1981).*

The pleading at issue here makes this case very different from that "normally" presented where it is alleged "that audited financial statements . . . [were] heavily relied upon by public investors" (Respondents' Brief at 11). *See United States* v. *Arthur Young & Co.*, 104 S.Ct. 1495, 1503 n.14 (1984).

The order below has the effect of providing a damage remedy to a class of persons who never read or relied upon the auditor's report and it encourages reckless market transactions and the very type of vexatious litigation found objectionable by the Court in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 739 (1975) ("[t]here has been widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general").

The question presented raises exactly the issues of *Panzirer* v. *Wolf*, 663 F.2d 365 (2d Cir. 1981), *cert. granted sub. nom. Price Waterhouse* v. *Panzirer*, 458 U.S. 1105, *vacated as moot*, 459 U.S. 1027 (1982). *See* Petition for Certiorari filed in *Panzirer* (No. 81-1998) on April 28, 1982. They remain as important now two years later as when the Court granted

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* Respondents' effort in opposition to the Petition to create a factual dispute for the first time has no colorable support.

certiorari to consider them but was denied the opportunity because of mootness.*

Since approximately one-third of all cases, public and private, brought under the federal securities statutes are 10b-5 actions, *see* 1 A. Bromberg & L. Lowenfels, *Securities Fraud and Commodities Fraud* § 2.5(6) (1983), it is imperative that the Court give guidance as to the contours of the causation/reliance element of the judicially created 10b-5 remedy. *See Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 737.

The potential breadth of the rule announced by the court of appeals cannot be overestimated. Statements that include information, rumor, advice, opinion and crystal ball gazing about publicly-traded companies are extremely widespread. They appear as news stories in the daily press; as articles ranging from topical events to "think pieces" in weekly publications of general orientation (*e.g.*, *Time*, *Newsweek*) and business orientation (*e.g.*, *Business Week*, *Barron's*); as spe-

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* In *Panzirer*, respondent unsucessfully opposed the petition, raising alleged disputes of "fact." *See* Brief in Opposition (No. 81-1998) filed May 27, 1982). *Panzirer* arose out of a contested motion for summary judgment and thus was in an analogous procedural posture. Because of the purity of the legal issues presented in a Fed.R.Civ.P. 12(b)(6) context, the Court has often granted certiorari in the procedural posture presented here. *See, e.g.*, *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, 444 U.S. 11 (1979); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560 (1979); *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976); *United Housing Foundation* v. *Forman*, 421 U.S. 837 (1975); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975). As stated in R. Stern & E. Gressman, *Supreme Court Practice* (5th ed. 1978):

> "where . . . there is some important and clear-cut issue of law that is fundamental to the further conduct of the case and that would otherwise qualify as a basis for certiorari, the case may be reviewed despite its interlocutory status." (*Id.*, § 4.19 at 301.)
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> "As long as the jurisdiction of the court of appeals has properly been invoked and a timely petition for certiorari filed, the Supreme Court has jurisdiction to take the case whatever its status in the lower courts. *The Conqueror*, 166 U.S. 110, 113." (*Id.*, § 2.2 at 53.)

cialized, paid-subscription services (*e.g.*, *Value Line Survey*); as investment letters or reports on in-house research by brokerage houses and investment advisors; and as tips, rumors and speculation circulating within the investment community. They are heard regularly on radio and television (*e.g.*, *Wall Street Week*).

Any such statement, opinion, rumor or tip can induce investment decisions. Many are expressly designed to do so. Under the holding below, auditors are faced with extensive discovery, trial and possible civil liability arising from every investment decision if the plaintiff merely alleges that his investment was preceded—and thus by hypothesis was influenced in some way—by misleading financial statements or the auditor's opinion thereon that the plaintiff has never seen or heard. The decision below would permit a 10b-5 action to be maintained upon the mere coincidence in time between the allegedly misleading financial statements and market gossip that persuades an investor to purchase.

The court of appeals relied on the Court's decision in *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972). In their opposition to the Petition so do Respondents. (*See* Respondents' Brief at 13n). That decision, however, involved silence in the context of face-to-face transactions giving rise to an affirmative duty to disclose. *Affiliated Ute* does not justify, and certainly does not compel, the rule announced below.

In *Affiliated Ute*, two bank employees, acting in a fiduciary capacity on behalf of the sellers and also as purchasers and market-makers for the securities in question, fraudulently failed to inform the sellers, in face-to-face transactions, (a) that the bank employees stood to gain from the transactions and (b) that a higher price for the securities could be obtained by selling on another market. 406 U.S. at 153. In *Chiarella* v. *United States*, 445 U.S. 222, 229-30 (1980), the Court characterized *Affiliated Ute* as involving silence—refraining from making any statement—in the context of an affirmative duty

to speak arising out of a fiduciary relationship of trust and confidence.

In the factual pattern and legal context of *Affiliated Ute*, the Court stated that when a 10b-5 claim involved silence, "positive proof of reliance is not a prerequisite to recovery" if materiality to the investor can be established. 406 U.S. at 153-54. It distorts *Affiliated Ute* beyond recognition to hold, as did the court below, that under *Affiliated Ute* an auditor who has issued an opinion on an issuer's financial statements is liable to a securities purchaser who never sees, reads or hears about the opinion or the financial statements and who has no business or fiduciary relationship with the auditor.

The legislative history of the Securities Exchange Act of 1934 does not permit the liberty taken by the court below. *See* Petition at pp. 8-10. And the lower courts and the commentators are by no means consistent in the adoption or interpretation of the efficient capital market hypothesis or market fraud theory.

Because of the "special function" of the independent auditor in our society, *United States* v. *Arthur Young & Co.*, 104 S.Ct. 1495, 1503 (1984), review of the decision below is particularly important.* The question presented, drawn entirely from the amended complaint, raises fundamental and clear-cut issues of law which impact upon this and many other cases.

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* Respondents are simply incorrect that this argument is a new one. (*See* Respondents' Brief at i). It bears repeating that in their amended complaint respondents distinguish between the company and its management on the one hand and the independent auditor on the other. *See* Petition at pp. 4-5 & n.1.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

VICTOR M. EARLE, III
Counsel of Record
ANTHONY J. COSTANTINI
Peat, Marwick, Mitchell & Co.
345 Park Avenue
New York, New York 10154

Of Counsel:

WILLIAM E. HEGARTY
CHARLES A. GILMAN
CAHILL GORDON & REINDEL
(a partnership including
professional corporations)
New York, New York 10005

CHARLES P. PILLANS
BEDELL, DITMAR, DEVAULT, PILLANS & GENTRY
Professional Association
1500 Barnett Bank Building
Jacksonville, Florida 32202